

components of the loop are recovered in recurring rates with the sole exception of placement of the cross-connect at the FDI in response to CLEC orders. Tr. 4757-60 (Peduto).¹⁹⁴

The non-recurring charge associated with loops, as proposed by Verizon, is duplicative of the maintenance expense reflected in recurring loop rates. The Commission has ruled clearly that “maintenance expenses relating to the local loop must be recovered through the recurring loop charge, rather than through a nonrecurring charge imposed upon the entrant.”¹⁹⁵

In sum, every time a CLEC pays for a loop it is paying the recurring rate to have that loop fully connected. The recurring cost of the loop set by this Commission must include all the components necessary to provide a complete communications path, including maintenance. The cost of a subpart of that path cannot be double counted as a non-recurring cost.

Proper identification of one-time costs is particularly important in a competitive environment where more than one local exchange carrier (including the incumbent) may use a particular facility at different points in that facility’s economic life. If the first telecommunications provider to use the facility bears all the forward-looking costs of a one-time activity benefiting multiple users, then obviously the first user will be forced to pay more than its fair share. AT&T/WorldCom Ex. 2 (Walsh Dir.) at 11; *see also* Local Competition Order at ¶¶ 745 and 750.

Verizon proposes to avoid double recovery by removing non-recurring revenues as a proxy from its ACF in the recurring cost models. This illogical and unnecessary maneuver proves the point that these field dispatch costs belong in the recurring cost study. An annual

¹⁹⁴ Verizon witness Curbelo asserted that Verizon avoided double recovery by removing certain non-recurring retail revenues from the annual cost factors in the recurring model, but was unable to provide any logical economic basis for the distinction. AT&T/Worldcom appropriately revised this calculation in its restatement of Verizon’s recurring cost study. AT&T/WorldCom Ex. 12P (Baranowski, et al. Reb.) at 93-4.

expense factor for maintenance provides a fair and appropriate method for full recovery from all users of the loop and the FDI cross connect. Verizon's proposal does nothing to address the Commission's concern that the cost be fairly distributed. Local Competition Order at ¶ 751 and Tr. 4858-61. Moreover, Verizon was unable to establish, in response to the Commission Staff's request that non-recurring revenues fully recover non-recurring costs. Verizon Record Response No. 19. Finally, Verizon will fully recover the cost in recurring rates. The difference is that the charges will be spread fairly over time, and competitors will not, therefore, face the large and unpredictable up-front charge proposed by Verizon.

3. Verizon's Cost Study Overstates Fallout And Service Order Costs.

Verizon has proposed excessive service order costs as a result of its assumptions regarding service order fallout. For example, Verizon has proposed a service order fallout rate for new orders of over 30%. Verizon Ex. 100 (Two Wire New Initial) TISOC, Line 1. VZ-VA Bates No. 004166. These rates reflect substantial manual intervention despite the evidence establishing that service orders can and will flow through Verizon's OSS electronically.

Verizon acknowledges that upon receipt of a properly and accurately completed electronic service order, it will incur no labor expenses in forwarding the electronic service order to its downstream provisioning systems. Yet despite this acknowledgment, Verizon assumes that it will need to process all service orders where a new entrant orders more than five lines on an order. Tr. 4812 (Peduto). The capability to query for facility availability is inherent in Verizon's OSS. Accordingly, the Commission should reject the service order charges proposed by Verizon which assume a manual facility check and which deny this capability of its OSS. The service order charge proposed by Verizon reflects the policy *chosen* by Verizon to remove orders for

¹⁹⁵ Local Competition Order at ¶ 745.

five or more loops from the electronic provisioning flow and to do a ‘facilities check’. There is no technological reason why orders for five or more loops cannot flow through the system without human intervention. Accordingly, no service order charge is appropriate for orders electronically submitted.¹⁹⁶

Moreover, Verizon concedes that the fallout rate for the typical one-line residential order is necessarily much lower. Tr. 4813-14 (Peduto). Thus, Verizon has skewed its rate structure to discourage this common order so crucial to development of competition.

This conclusion is only confirmed by Verizon’s eleventh hour admission that its TISOC study was not conducted by Anderson Consulting as Verizon had stated in its testimony. During cross-examination, Verizon’s witnesses established that no documentation exists to support the TISOC task times which Verizon relies upon in this case. Tr. 4689 (Curbelo). Apparently, in searching for some shred of evidence to support its proposal, Verizon discovered that Anderson had not even conducted the study and had subsequently produced lower results. *See* Verizon’s Motion for Leave to File Corrected Non-Recurring Cost Study and Errata to Testimony. In fact, when Anderson did conduct a review, it revealed that Verizon’s “study” substantially overstated the times. *Id.* Although Verizon has not even adopted the data developed by Anderson, it is clear that both should be rejected as flawed, unsubstantiated and based on embedded cost assumptions. As with the rest of Verizon’s NRC study, neither meets the burden imposed on Verizon by 47 C.F.R. § 51.503(e).¹⁹⁷

¹⁹⁶ The cost to manually handle the two per cent of orders that may be expected to fall out is reflected in the provisioning rates of the NRCM and is spread over all orders, including those which do flow through. Thus, there is no separately stated service order rate in the NRCM, although the cost built into the provisioning rate amounts to 26 cents per order.

¹⁹⁷ 47 C.F.R. § 51.503(e) states:

(e) *Cost study requirements.* An incumbent LEC must prove to the state commission that the rates for each element it offers do not exceed the forward-

An added benefit of setting appropriate forward-looking rates is that such rates should provide Verizon with an incentive to provision UNEs more efficiently because these rates reflect more forward-looking processes. If the Commission sets rates that reflect efficient forward-looking processes, Verizon is more likely to implement forward-looking efficient processes for provisioning UNEs, rather than bear the cost of the inefficient processes.

This Commission should follow the lead of the commissions in Illinois, Massachusetts, Connecticut, Minnesota, and the Recommended Decision presently before the New York Commission, who have all found that the 2% fallout rate is the appropriate forward-looking fallout rate.¹⁹⁸

4. Verizon's Non-Recurring Charge Proposal Reflects Inefficient Manual Coordination Costs That Inflate The Cost Of Provisioning New Entrant Orders

Verizon's study contains substantial, but unnecessary costs for manual coordination. The RCCC group that performs this role does not fulfill a single physical task that is actually required to provision service, but is simply a work group that was created as an overlay to a normally

looking economic cost per unit of providing the element, using a cost study that complies with the methodology set forth in this section and § 51.511 of this part.

¹⁹⁸ *Investigation into the compliance of Illinois Bell Telephone Company with the order in Docket 98-0486/056/ Consolidated regarding the filing of tariffs and the accompanying cost studies for interconnection, unbundled network elements and local transport and termination and regarding end to end bundling issues*, Illinois Commerce Commission, Order Case No. 98-0396. Oct. 16, 2001; Massachusetts Department of Telecommunications and Energy, *Order on NRCs, OSS Cost Recovery, and House and Riser - Consolidated Arbitrations*, Docket 96-80/81, Oct. 14, 1999 at 10-16; Connecticut Department of Public Utility Control, *Investigation of the Southern New England Telephone Company's (SNET) Proposed Unbundled Network Elements (UNE) Non-Recurring Charges (NRCs)* Docket # 98-09-01, Jan. 5, 2000, at 34; *In the Matter of a Generic Investigation of US West Communications, Inc.'s Cost of Providing Interconnection and Unbundled Network Elements*; OAH Docket No. 12-2500-10956-2, Nov. 17, 1998 at 75; *Recommended Decision on Module 3 Issues*, New York Public Service Commission, Case 88-C-1357, May 16, 2001 at 190.

mechanized flow of non-recurring work activity. The RCCC group's costs are imposed only on CLECs. Verizon freely admits that it does not deploy equivalent work groups for its retail services. Tr. 4882-3 (Curbelo).

Verizon's costs of manual coordination result from the inefficiencies of its existing network and procedures and are not forward-looking. These RCCC costs reflect an existing administrative process that requires substantial amounts of inefficient labor to coordinate and monitor Verizon employees' work progress and to resolve internal Verizon roadblocks. Verizon would not incur these costs if its operations for CELC orders were truly mechanized and efficient. In a forward-looking efficient network environment, employees use automated systems to coordinate as well as perform the work required by service order requests. In a forward-looking efficient network environment, the coordination functions performed in part by the RCCC are automated in Verizon's OSS. Coordination of provisioning activities is one of the basic capabilities of modern OSS, and a forward-looking cost study must recognize this.¹⁹⁹

AT&T and WorldCom are not alone in this view. The Rhode Island PUC recently rejected all of Verizon's proposed RCCC costs as double recovery of the supervisory administration overhead inconsistent with TELRIC, stating:

The Commission shares the Division's concern that the costs associated with the Coordination Bureau are unnecessary. Special coordination charges that apply only to work being done for UNEs might well amount to double-recovery or ordinary supervision overhead expenses and could, therefore, constitute a barrier to entry. Accordingly, we order that no such costs be included in any future TELRIC cost studies in this docket.²⁰⁰

Again, this Commission should reject Verizon's proposal as the Rhode Island Commission did.

¹⁹⁹ See Verizon Ex. 124, Attachment E, p. 5.

²⁰⁰ State of Rhode Island and Providence Plantations Public Utilities Commission, *In re: Review of Bell Atlantic Rhode Island TELRIC Study*, Docket No. 2681 at 68.

The lack of foundation in Verizon's cost study for its costs of manual coordination is demonstrated graphically by the fact that the coordination function takes substantially longer than the work effort that is actually required to provision an order. For example, Verizon's cost study lists "forward looking" work activities for the RCCC, totaling 74.61 minutes, which Verizon claims is necessary for provisioning hot-cut orders. Ex. 100, Worksheet #3, Two Wire Hotcut Initial, RCCC, Line 39. Bates No. VZ-VA 004183. This far exceeds the actual time alleged to be necessary to wire and cut over the customer at the central office frame. Verizon Ex. 100, Worksheet #3, Two Wire Hotcut Initial CO FRAME, Line 29. Bates No. VZ-VA 004183. The actual time shown in Verizon's study for a CO frame technician to place the cross-wire is less than 15 minutes. Verizon Ex. 100, Worksheet #3, Two Wire Hotcut Initial, Lines 2, 6. Bates No. VZ-VA 004183.

Verizon seeks to justify the cost of all manual coordination on the ground that CLECs have asked for coordination. Verizon Ex. 116 (NRC Panel Reb.) at 6. However, CLEC requests for coordination in the face of Verizon's current inefficiency do not justify, even as a short-run phenomenon, NRCs for internal manual Verizon coordination. Moreover, most of the manual coordination that Verizon has included in its NRCs is internal coordination among Verizon work groups. It is not coordination with the CLEC. Verizon's study includes an extreme amount of coordination because it redundantly includes several tasks that are or should be automated. For example, the study includes the cost of manually providing completed order information to new entrants even though the notification of order completion will be automated for new entrants that

submit orders electronically. The manual notification Verizon has built into its study is duplicative and needlessly costly.²⁰¹ The automated notice process in place is sufficient.

Even if some coordination is required at the outset of the competitive era, it is unreasonable to presume that Verizon will require a permanent, long run process of manual oversight of its workforce for every unbundled element ordered. While there may be coordination activities in the early stage of competition (before electronic bonding systems are fully implemented) the TELRIC standard requires that NRCs reflect the efficient operations that will prevail in the long run. Moreover, ILECs have no incentive to fully deploy least cost, most efficient, operations when they are permitted to recover NRCs for manual activity from CLECs.

In addition to manual coordination costs, the Verizon study includes other costs for functions that should be automated. For example, the study includes five separate tasks (even for a single line order) for a person called a screener to assign an order to another person (the coordinator) who will do the coordination. Verizon Ex. 100 (Two Wire New Initial) RCCC, Lines 1-5, Bates No. VZ-VA 004166. The same five tasks are piled on the disconnect costs, but the different and higher task times for the identical activities reveals another obvious flaw in Verizon's survey data. This redundant manual effort is used instead of having electronic orders from new entrants automatically channeled to qualified personnel.

Verizon's proposed non-recurring charges include a large number of manual coordination activities that are unnecessary because the mechanized capabilities inherent in Verizon's OSS

²⁰¹ Verizon's study (Verizon Ex. 100 (Bates No. VZ-VA 004183, Two Wire Hot Cut Initial)) demonstrates that they will contact the RCCC Task #18 "Contact CLEC to verify activity" (6.76 minutes) duplicated on RCCC Task #23 "On DD, contact CLEC for final authorization to proceed." (3.15 minutes) On top of that, Task #25 adds "Proceed with the HOT CUT conversion; notify all Bell Atlantic teams to proceed; advise CLEC when HOT CUT is complete. (9.16 minutes). This proposes 3 separate phone calls in addition to Task #26, Complete the order.

should perform the functions. The RCCC tasks reflect manual processing activities that are redundant and reflect nothing more than work already performed by the OSS. Inclusion of these current RCCC costs in non-recurring charges will drive up CLEC costs to the point where CLECs will not be able to compete with Verizon. If this occurs, consumers will be denied the benefits of competition.

Some activity reflected for the RCCC relates to field dispatch work. Even though Verizon proposes to charge for field installation only when dispatch occurs, costs for the related activities of the RCCC and other groups are included on all orders.²⁰² This is one of several examples where Verizon reflects costs for activities that will not occur.²⁰³

5. The Survey Method Verizon Used To Develop Its Proposed Non-Recurring Costs Is Seriously Flawed And Statistically Meaningless.

Verizon developed its rate proposal based on a “survey” of its employees, but the study process suffers from so many major shortcomings that it cannot be used to set rates. For one thing, Verizon’s methodology was intended to generate longer task times, and thus higher costs, because it asked the employees themselves to identify the time required for certain activities. Any employee filling out a survey asking about how much time it takes to complete certain tasks will have a natural human inclination to over-state work times so as to inflate his/her importance and to inflate the complexity of one’s job.

(6.75 minutes), which should simply and automatically send completion information to the CLEC.

²⁰² See Tr. 4796-8 (Peduto).

²⁰³ Another example is the contention that an identical percentage of migrations and new orders will require TISOC handling even though facilities are already in place for migrations. Tr. 4820-6 (Peduto and Curbelo). Another example, conceded by Verizon during cross-examination is the charge for CO wiring on 100% of new UNE Platform orders even though the wiring will already be in place. Tr. 4843-4 (Peduto). See also the discussion below of Verizon’s proposed up-front collection of disconnect charges below.

Moreover, Verizon's methodology locks in embedded inefficiencies. The survey required respondents to estimate task times based on embedded processes, not forward-looking processes. The form Verizon used directed the respondents to ignore planned process improvements unless specifically instructed on a separate form to reflect certain specifically defined forward-looking circumstances. This captures the costs of embedded processes, not the forward looking costs of operating an efficient network. Verizon Ex. 100, Ex. Part H, Section K, Bates No. VZ-VA 004148.

To ensure that the results would be biased towards longer task times, Verizon practically invited its employees to make the estimate as long (and as expensive) as possible. Twice on the first page of the survey instructions, employees are advised that the results will be used to establish the rates Verizon will charge its competitors. *Id.* Bates No. VZ-VA 004147. Tr. 4715-6 (Goldrick). The import of this warning flag could not have been lost on the employees filling out the form. The kickoff memorandum to the management team for the surveys urged company loyalty, stating that inadequate survey data "jeopardizes our ability to recover our costs and strengthens the positions of our opponents (AT&T, MCI WorldCom, Sprint, etc.) . . ." *Id.* at Section J, Bates No. VZ-VA 004144. Treating the development of forward-looking costs as a competitive sport in which the goal is to defeat the CLECs, *i.e.*, the customers for the services being provided, is certainly not a reasonable approach for obtaining unbiased and accurate results.

Verizon survey methodology suffers from so many errors the results are statistically useless. The vague survey instructions invited and, in fact, elicited irreconcilably disparate ranges of responses for the same activities. It is clear that the respondents did not have consistent understandings of the questions being asked. AT&T/WorldCom Ex. 13P (Panel

Reply) at 78-82. Despite this, and despite Verizon's assertion that it removed outliers, the results relied on in the NRC study vary so greatly as to be unreliable. *Id.* at 83-84. Verizon's failure to adequately document its process simply exacerbates the problem and renders the results useless.

Finally, even if current work times were relevant (which they are not), the methodology of weighing each response equally regardless of whether it represented one or a thousand occurrences of the reported task rendered the survey data totally useless for establishing average times. Tr. 4699-4709 (Verizon NRC Panel). Finding Verizon's survey method unreliable, the Rhode Island Commission opted to re-calculate Verizon's task times using the minimum rather than the mean task times. This reduced the estimate by approximately 57%.²⁰⁴

The final flaw in Verizon's methodology is the most damaging – the results of the survey (which Verizon witness Goldrick asserts provide the crucial difference between the competing studies (Tr. 4946 (Goldrick)) are irrelevant to the costs that Verizon proposes. By Verizon's own admission, the forward-looking task times which are the basis for its proposed rates were fashioned by a panel of unidentified experts and the only documentation or record of that effort is the column of results in the spreadsheets of the model. Tr. 4794 (Peduto).²⁰⁵ In fact, the process was updated in June 2001 and despite explicit instructions to document the interviews, no record was kept. Verizon Ex. 100, Ex. H line Section M, ¶ 3, Bates No. VZ-VA 004150²⁰⁶

²⁰⁴ Rhode Island Opinion at 68.

²⁰⁵ In stark contrast, the basis of each of the results and task times in the AT&T/WorldCom NRCM can be found in the NTAB and the model documentation filed with the model.

²⁰⁶ Addressing this flaw, the Rhode Island Commission warned Verizon, "We also require that any sampling of "experts" by Verizon be better-documented, statistically appropriate, and based on specific plans for its revised Operations Support Systems, and not just the experts' unguided and undocumented speculations as to how Verizon's operations might change as a result of local exchange competition." Rhode Island Opinion at 63.

As demonstrated above, the Verizon study should be rejected because it relies on faulty assumptions and methods and offers no evidentiary justification for the costs it proposes.

6. Consistent With A Forward-Looking Methodology, Non-Recurring Costs Of Disconnection Should Be Assessed Only When A Disconnect Order Is Placed.

The NRCM develops separate disconnection charges that will be assessed at the time a CLEC places a disconnect order. In contrast, Verizon's proposal requires that the cost of disconnection be paid up-front when the service order for connection of a customer is first placed.

Assessment of a separate disconnect charge at the actual time of disconnection, as is proposed in the NRCM, more accurately adheres to the principle of cost causation. Moreover, the separate charge for disconnection reflects the reality that telephone companies do not necessarily 'disconnect service' when service is deactivated. That is, the facilities providing service are not usually physically disrupted. The physical facilities remain in place; only a command from the OSS is required to activate or deactivate service. Verizon and other telephone companies adhere to this practice because it allows for immediate service activation to the next customer at a given premise. The NRCM appropriately reflects this practice; the disconnection charges proposed by Verizon do not.

Second, disaggregating provisioning and disconnection charges will reward companies who provide superior service and thereby retain their customers. A new entrant might choose to leave facilities in place (and continue to pay for the UNEs) even after a customer leaves the premise. This will provide the next tenant with a warm dial tone to the new entrant's business office. Verizon's suggestion that it might not leave facilities in place is a clear example of an anti-competitive act that would make it difficult for new tenants to maintain service with the new

entrant. AT&T/WorldCom Ex. 8 (Murray Dir.) at 38; *see also* AT&T/WorldCom Ex. 12 (Panel Reb.) at 72.

In sum, the combining of provisioning and disconnection costs in Verizon's proposed rates is unreasonable and anti-competitive. This system forces new entrants to pay for services they have not ordered and penalizes companies which, due to superior service, may not require a disconnection. In contrast, separating the provisioning and disconnection NRCs, as proposed by AT&T/WorldCom, helps reduce the barrier to entry that all up-front costs represent. Verizon's proposal runs afoul of the Commission guidance that costs must be recovered in the manner that they are incurred.²⁰⁷ Application of this rule, as proposed by AT&T/WorldCom will prevent recovery of costs for activities that never occur. The Rhode Island Public Utility Commission agreed with this conclusion in a recent decision that rejected Verizon's proposal:

While the inclusion of the disconnection cost has long been a standard practice in the calculation of Verizon's nonrecurring *retail* installation charges, we are not convinced that the inclusion of similar costs at the time of service initiation are warranted, or even appropriate, in the case of *wholesale* installation charges. Rather, we are persuaded by the Division's concerns that imposing such a requirement on CLECs "does not reflect the realities of the interconnection and UNE market because interconnection and UNE customers are unlikely to leave the ILEC holding the bag ... Accordingly, we hereby prohibit Verizon from including in its nonrecurring costs a disconnection charge at the time of service initiation. In addition, we require that in future TELRIC cost studies, the cost of disconnection shall be made a separate rate element from the cost of connection."²⁰⁸

This Commission should also reject Verizon's proposal. Verizon's proposal to aggregate disconnect charges poses all of the barriers to entry dangers identified in Paragraph 747 of the

²⁰⁷ Local Competition Order at ¶ 743.

²⁰⁸ Rhode Island Opinion at 66-7.

Local Competition Order.²⁰⁹ When questioned on this point, Verizon witnesses Shelanski and Tardiff could do little more than acknowledge that “you don’t want to charge for tasks that you are not going to end up performing” Tr. 3226-3231.

D. The Commission Should Reject Verizon’s Proposals for Line Sharing/Line Splitting as Excessive and Not Forward-Looking.

Verizon has made proposals for two different splitter arrangements but has not addressed all of the technically feasible options nor has it proposed prices for line sharing arrangements that were stand alone unbundled DSL-cable loops over fiber-fed loops. AT&T/WorldCom proposes to address pricing of additional service offering options once they become available from the New York DSL collaborative. In addition, the Commission should prohibit Verizon or any of its affiliates from providing DSL-based services over fiber facilities in Virginia until Verizon has set forth terms, conditions and prices that would allow only affiliated competitors access to that capability.²¹⁰

The Commission should require competitors to pay for access to Verizon’s wide band testing capability only if they choose to use that system and only if Verizon provides full access to the system. The benefits from the wide band testing capability offered by Verizon may be unnecessary for CLECs or duplicative of capabilities which the CLECs already have access to.²¹¹ In addition, the Verizon costs are overstated and should be reduced accordingly.²¹²

²⁰⁹ See footnote 4.

²¹⁰ See Order, *Investigation by the Department on its own motion as to the propriety of the rates and charges set for in M.D.T.E. No. 17*, D.T.E. 98-57-Phase III at 80 (Sept. 29, 2000) at 94-96; Public Service Commission of Maryland, Case No. 8842, Phase I, Order No. 76488, Oct. 6, 2000, at 15-16; and New York Public Service Commission, Case 00-C-0127, Opinion No. 00-12, issued and effective, Oct. 31, 2000, at 25-27. See also, Illinois Commerce Commission Arbitration Decision, Dockets 00-0312 and 00-0313, Aug. 17, 2000, at 31.

²¹¹ AT&T/WorldCom Ex. 13P, Panel Reply Testimony on Non-Recurring Costs and Advanced Data Services, pp. 103-105. Also, see New York Public Service Commission, *Opinion*

With regard to Verizon's proposed per line charge for modifications to its OSS in connection with line sharing, the Commission should reduce the cost and, in any event, remove it to the recurring cost study.²¹³ The remaining proposed cost should be rejected as lacking in any evidentiary basis.²¹⁴ Nevertheless, if the Commission decides to make use of Verizon's proposed cost study for line sharing OSS, it should reduce those costs accordingly and spread them over ten years resulting in a charge of \$0.54 per month per line.²¹⁵

Verizon has attempted to estimate a non-recurring cost for line sharing arrangements using the two wire new UNE loop as a proxy. This approach should be rejected as lacking proper foundation.²¹⁶ In addition, the Commission should calculate costs based on the assumption that Verizon will place splitters at or near the MDF, thus accomplishing the most efficient configuration.²¹⁷

The Commission should reject as overstated and inappropriate Verizon's proposals for (1) an EFI factor for line sharing,²¹⁸ (2) admin and support²¹⁹, (3) splitter installation²²⁰, and (4) cooperative testing.²²¹

and Order Concerning Line Sharing Rates ("NYPSC Line Sharing Order"), Case 98-C-1357, Opinion No. 090-07, issued May 26, 2000, at 25-26.

²¹² AT&T/WorldCom Ex. 13P (Panel Reply) pp. 111-15.

²¹³ *Id.* at 16.

²¹⁴ *Id.* at 117-18.

²¹⁵ *Id.* at 118.

²¹⁶ *Id.* at 119-22.

²¹⁷ *Id.* at 122-23.

²¹⁸ *Id.* at 125-29.

²¹⁹ *Id.* at 129-33; *See also* Public Service Commission of Maryland, Order No. 76852, at 26-27.

²²⁰ *Id.* at 136-38

²²¹ *Id.* at 138-142; *See also* Massachusetts Order at 113 and Maryland Order 76852 at 39.

Verizon proposes to create an additional non-recurring charge for adding electronics in order to provide ISDN-type service over longer all-copper loops. This is another example of a cost which Verizon has identified only by assuming inconsistent networks for recurring and non-recurring costs. Additionally, Verizon seeks to add another NRCs in the form of a loop qualification charges to its competitors in order to recover the cost of creating and maintaining an automated loop qualification database. The Commission should not allow any of these charges in a forward-looking environment because they represent costs which are either unnecessary in a forward-looking network or duplicative of recurring costs. *See* AT&T/WorldCom Ex. 13P, Panel Reply on Non-Recurring Costs and Advanced Data Services, at 151-57.

E. Verizon Improperly Proposes Charges for Line Conditioning Which are Not Consistent with Forward-Looking Network Assumptions; These Costs Should Be Recovered Through Recurring Charges if Recovered at All.

Verizon proposes to charge line conditioning charges for the removal of bridged taps less than 6,000 feet long on all loops and load coils from loops greater than eighteen thousand feet. This proposal is clearly at odds with TELRIC principles. As Mr. Walsh states in his direct testimony:

A properly reconstructed network, as suggested by the TELRIC pricing guidelines, would include this requirement. Therefore, the forward-looking design of the recurring network, if engineered using the most efficient technology for reasonably foreseeable capacity requirements, would not include load coils and would have minimal bridge taps.

AT&T/WorldCom Ex. 2 (Walsh Dir.) at 26. Indeed, the recurring loop cost studies Verizon submitted to the Commission do not include any load coils and reflect cable sizing that is sufficient to provide dedicated facilities for all existing and reasonably foreseeable loop demand

without resorting to the use of bridged tap. Thus, Verizon has admitted that a forward-looking network would not require “conditioning” to provision DSL-capable loops. AT&T/WorldCom Ex. 13P, Panel Reply, p. 144. Thus, under TELRIC, there is no need to include loop conditioning as an element in the NRC model.

This approach is fully consistent with the Commission’s directives. The UNE Remand Order at ¶ 152 requires that loop conditioning costs be forward looking:

Thus, we see no reason to depart from the use of the TELRIC-based methodology adopted in the *Local Competition First Report and Order* for this new [line conditioning] unbundled network element.

The *Order* continues at ¶ 157:

As we stated in the *Local Competition First Report and Order*, the price for unbundled network elements should be based on forward looking costs.

Verizon’s proposals are at sharp odds with the Commission’s requirements. Verizon admits in its testimony that its calculations for loop conditioning costs are based on the existing network because that is what is being modified. Clearly, Verizon’s proposal is not TELRIC compliant.

Verizon’s attempt to institute an NRC for loop conditioning is also inappropriate (Verizon Panel at 38) because, by its very nature, loop conditioning is a recurring activity. Once a loop is conditioned, it becomes available to all users of the network and should therefore be an aspect of the recurring rates. AT&T/WorldCom Ex. 2 (Walsh Dir.) at 26-27. These are permanent changes to the network that remain in place long after the CLEC’s request. *Id.*

If the Commission, nonetheless, decides to permit non-recurring charges for line conditioning, they should reflect least-cost most efficient work practices. In particular, contrary

to the Verizon proposals, line conditioning should be done in binder groups of 25 or 50, thus producing much lower per unit charges. AT&T/WorldCom Ex. 13P, pp. 148-151 and Attachment A.

III. VERIZON'S WHOLESALE DISCOUNT COST STUDY IS FUNDAMENTALLY FLAWED AND DOES NOT JUSTIFY A DECREASE IN THE WHOLESALE DISCOUNT. [AT&T ONLY]

Verizon advocates a wholesale discount for CLECs providing their own operator services and directory listing service of 14.68%, and 13.06% using Verizon's operators.²²² Those rates are substantially worse than what the Virginia State Corporation Commission adopted in November 1996: 21.3% when CLECs provide their own operators and 18.5% using Bell Atlantic – VA's operators.²²³

Verizon cites *Iowa Utils. Bd. v. FCC*²²⁴ in support of its arguments for weakening the wholesale discounts, but its interpretation of that decision is overreaching, inconsistent with the Telecommunications Act, and yields an inappropriately low wholesale discount that would allow Verizon to recover avoided retail costs. Rather than determine the portion of retail rates attributable to Verizon's retail operation, Verizon has treated as avoided only those costs that are entirely eliminated when Verizon sells services at wholesale, *even if the costs were incurred to support Verizon's retail operation*. In other words, to the extent a function allegedly supports both Verizon's retail and wholesale operations, Verizon incorrectly treats the entire cost as not avoided.

²²² Tr. 3712 (Minion).

²²³ For GTE, the wholesale discount was 20.6% when GTE provided operators and 23.4% when GTE did not.

²²⁴ *Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000), *vacated and remanded in part*, *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 1133 (2001).

That defect is evident in Verizon's handling of its advertising expenses. Verizon's advertising expenses are clearly retail costs, as they attempt to convince consumers to purchase Verizon services. Verizon's advertising costs do not benefit reseller CLECs, of course, as the goal is to stimulate retail sales of Verizon's services. That Verizon's cost model treats *all* of its retail advertising costs as unavoided shows how deeply flawed Verizon's methodology is.²²⁵

The FCC should also reject Verizon's invitation to adopt a different wholesale discount for stand-alone services. Verizon speculates that if it resells a stand-alone service, like a vertical feature, it somehow avoids fewer retail costs than if it sold basic service with vertical features. Verizon ignores the fact that if it retains the customer's basic service business, it still receives its full retail rate, which covers its retail costs. There is no basis for Verizon's assumption that the avoided costs are different for stand-alone services.

Because Verizon's cost study does not treat all of its retail costs as avoided, the FCC should not lower the wholesale discount. Instead, the FCC should leave the existing wholesale discount in place until the FCC has an opportunity to revise its rules for calculating the wholesale discount consistent with *Iowa Utils.*

A. Verizon's Interpretation of *Iowa Utilities Board* Is Overreaching And Yields An Incorrect Discount Rate.

The Act requires that incumbent LECs sell services to other carriers for resale. The specific language in 47 U.S.C. § 252(d)(3) is that "a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, *excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.*" (Emphasis added). Thus, to

²²⁵ Tr. 3705 (Kirchberger); 3716 (Minion).

determine wholesale rates, the Act identifies marketing, billing, and collection as costs that are to be excluded. The Act also prescribes the removal from retail rates of any “other costs” that will be avoided.

In *Iowa Utils.*, the Eighth Circuit construed the phrase “avoided costs” as it is used in the calculation of the wholesale discount. The court stated:

The phrase “will be avoided” refers to those costs that the ILEC will actually avoid incurring in the future, because of its wholesale efforts, not costs that “can be avoided.” . . . The plain meaning of the statute is that costs that are actually avoided, not those that could be or might be avoided, should be excluded from the wholesale rates.²²⁶

Verizon’s cost study is inconsistent with the Eighth Circuit decision. Verizon’s claim is that it will avoid few retail costs when it operates in a wholesale environment. Nothing in the Eighth Circuit decision, however, precludes the logical assumption that the ILEC will behave like a rational business and will avoid all costs that it can. Indeed, Verizon agrees that its goal is to “act as a rational business that adopts cost minimizing strategies.”²²⁷ Without that presumption, the underlying premise would be that the ILEC would continue incurring retailing-related costs, even if the end-user had migrated to a CLEC.

In addition, Verizon’s cost study ignores the Eighth Circuit’s holding that “avoided costs” are costs the ILEC will “actually avoid incurring *in the future*.”²²⁸ The Act clearly contemplated a fully competitive local service market in the future.²²⁹ Verizon’s cost model, however, implicitly assumes a market *exactly as it is today*—with one provider

²²⁶ 219 F.3d 744, 755 (8th Cir. 2000) (emphasis added).

²²⁷ Tr. 3748 (Minion).

²²⁸ 219 F.3d 744, 755 (8th Cir. 2000) (emphasis added).

²²⁹ *Id.* at 744, 747 (emphasis added).

(Verizon) retaining a near monopoly in its retail operation, and with resale competitors having a tiny fraction of the market. Verizon's cost model treats the overwhelming majority of its retail costs as unavoided retail costs because it implicitly assumes there is so little resale competition — an assumption contrary to the Act.

Verizon's incorrect reading of the *Iowa Utils.* decision corrupts the very foundation of its cost study. In essence, Verizon tallied all costs and then stripped out the costs attributable *solely* to retail sales.²³⁰ The result is that costs that support *both* Verizon's retail and wholesale operations are not avoided. That causes CLECs to shoulder a portion of Verizon's avoided retail costs if even a sliver of the costs also support the wholesale operation. This error, coupled with Verizon's failure to assume a competitive marketplace, causes it to treat a host of avoided costs as unavoided.

B. Verizon's Errors In Methodology Cause It To Treat Obviously Retail Costs Like Product Advertising As Unavoided.

Verizon treats the lion's share of its cost as unavoided. The result is to load Verizon's retail expenses onto resellers in the form of inflated wholesale prices.²³¹ This means that resellers effectively would wind up paying for some retail functions twice: to support its own retail operations and to support Verizon's.

The most obvious example is Product Advertising. Verizon treats *all* of its own retail advertising expense as not avoided. Put differently, when the market becomes competitive in the future and CLECs capture a substantial market share, Verizon assumes that it would not

²³⁰ Tr. 3726-27 (Minion) (Verizon's cost study is "binary" in that it treats a particular function as entirely avoided or entirely not avoided).

²³¹ Tr. 3708-09 (Kirchberger) ("Verizon will avoid retail advertising costs associated with wholesale lines, and therefore [those costs] should not be included in the wholesale price.").

cut its advertising budget by even one dollar.²³² Verizon further argues (without support) that its retail advertising will somehow stimulate demand for CLECs' services²³³ — which illustrates Verizon's view that if it can conjure a baseless theory that even a sliver of a retail expense indirectly supports its wholesale operation, the entire expense is unavoided. Verizon's approach to product advertising is the clearest example of how Verizon's cost model is overreaching and inconsistent with the Act.²³⁴

Equally troubling are the implications for CLECs of allowing Verizon to treat all of its advertising budget as unavoided. CLECs must pay for their own advertising to capture retail market share, of course. But Verizon would be allowed to continue its own retail advertising efforts subsidized by resellers. CLECs would pay for advertising twice, once for their own, and once by having Verizon's advertising included in the resale price — something that neither the Eighth Circuit nor the Act contemplates.

Another flaw in Verizon's cost study is that it uses a "customer-by-customer" approach in determining which costs are avoided. Accordingly, Verizon admits that it only treats a cost as avoided if its operations change due to the migration of that individual customer:

MRS. PREISS: . . . [W]hat I'm trying to get at is what standard should the FCC use to assess how [Verizon] is likely to act with respect to its wholesale services? . . .

MR. MINION: I think what the FCC needs to do is examine the operations and in examining those operations make an assessment when an individual customer moves to the reseller what is going to

²³² Tr. 3707-08 (Kirchberger); 3757 (Minion) (if Verizon's retail advertising budget were based on retail revenues, a reduction in retail revenue could hypothetically lead to a reduction in advertising expense).

²³³ Tr. 3719, 3721 (Minion) (admitting that Verizon's position that its retail advertising will stimulate retail sales for CLECs is "not based upon any study").

²³⁴ Tr. 3697-98 (Kirchberger).

be the – how is the operation going to change relative to that customer.²³⁵

The flaw in this approach is that it entirely ignores the cumulative effect of a substantial number of customers migrating from Verizon to a reseller – a very realistic possibility in a truly competitive future marketplace. In other words, the loss of a single customer may have no impact on Verizon’s indirect costs. The loss of a significant number of customers will certainly impact the cost structure of a rational business.²³⁶ Verizon’s cost study necessarily fails to properly account for a migration of large numbers of its retail customers to resellers in the future.

C. The FCC Should Not Adopt A Separate Discount Rate For Stand-Alone Services.

The Act imposes on ILECs the obligation to offer for resale “any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers.”²³⁷ Vertical features are separately-priced tariffed services, so Verizon has an obligation to resell them at the wholesale discount ordered by this Commission. Nevertheless, Verizon claims that it should be allowed to offer these “stand-alone” services for resale at a different (presumably lower)²³⁸ wholesale discount rate, reasoning that if the reseller were reselling only a vertical feature, Verizon “would continue to provide the basic dial tone service and would not necessarily avoid any costs.”²³⁹

²³⁵ Tr. 3748 (Minion) (emphasis added).

²³⁶ Tr. 3755-56 (Kirchberger) (when market share loss becomes significant, indirect costs decline).

²³⁷ Telecommunications Act, Section 251(c)(4)(A).

²³⁸ Tr. 3714-15 (Minion).

²³⁹ Verizon Exh. 107 (Verizon Panel Dir.) at 365-16; Tr. 3714-15 (Minion).

The fallacy in Verizon's analysis is that if a reseller purchases a stand-alone retail feature but Verizon provides basic service, Verizon still receives from the customer *the full retail rate* for the basic service. Verizon has made no showing that avoided costs differ for vertical features. Verizon necessarily avoids the retail expenses associated with the stand-alone service itself, so the discount should be the same despite Verizon's speculative assertions.

Moreover, Verizon offered no evidence to establish the level of the discount rate for stand-alone services. Verizon proffered no study analyzing the extent to which a different level of costs is avoided for stand-alone services, and indicated that it had no plans to conduct such a study.²⁴⁰ Indeed, Verizon conceded that its position that the discount rate for stand-alone services would be lower (or even different) than the rate for Verizon other services was "speculation."²⁴¹ Obviously, Verizon's unsupported speculation is not sufficient basis for the Commission to establish a separate discount rate for stand-alone services, so stand-alone services should be offered at the wholesale rate established for Verizon's other services.

D. The FCC Should Not Disturb The Existing Virginia Wholesale Discount Rate Until It Adopts New Rules.

Verizon represents the Eighth Circuit decision as "the final word on the applicable law" and that its cost study is "designed to comply with the guidance provided by the Eighth Circuit."²⁴² In fact, neither Verizon nor AT&T (nor anyone else, for that matter) knows for certain how the wholesale discount should be calculated post-Eighth Circuit.²⁴³

²⁴⁰ Tr. 3715-16 (Minion).

²⁴¹ Tr. 3715 (Minion).

²⁴² Verizon Exh. 107 (Verizon Cost Panel Dir.) at 338.

²⁴³ Tr. 3741 (Kirchberger) (stating that AT&T is "looking for administrative guidance . . . to be able to develop new rules through rulemaking where res[ellers] can actively participate because this is their life blood").

Indeed, Verizon acknowledges that, under the Eighth Circuit decision, the Commission must somehow predict how Verizon will act *in the future* to evaluate which costs will be avoided. Mr. Minion testified:

MS. PREISS: Even if your current operations are a starting point for analyzing what Verizon will and won't do in the future, are you disagreeing with my statement that requires the Commission to make some sorts of prediction or at least have an understanding of how Verizon is going to act?

MR. MINION: I think that's a fair statement. You do need to make an assessment as to how Verizon's operations will necessarily change.²⁴⁴

Therefore, Verizon concedes that the Commission must make a prediction about how Verizon's operations will change going forward. On the record before it, the Commission has been given little information to discern how Verizon's operations will change in the future, which the Eighth Circuit's Order seems to contemplate.

Even more problematic is that the FCC has yet to revisit its wholesale discount rules in light of the Eighth Circuit decision. The FCC has two choices for correcting Verizon's mistakes. One is to do so within the confines of this proceeding. The other, and the one AT&T recommends, is to leave the existing wholesale discount in place for now until the FCC has an opportunity to revise its rules for calculating the wholesale discount.²⁴⁵ Even at the 21.3% discount available since late 1996, the resale market in Virginia is virtually nonexistent.²⁴⁶ Reducing the wholesale discount, as Verizon proposes, would drive a permanent stake in the heart of resale competition because a lower wholesale discount would make resale an even less

²⁴⁴ Tr. 3747 (Minion).

²⁴⁵ Tr. 3703, 3705 (Kirchberger).

²⁴⁶ Tr. 3729 (Minion) (total number of resale lines is about 3 percent of the total lines in Virginia).

attractive alternative than it is now. If resale is to take hold in Virginia, the Commission should not lower the discount based solely on Verizon's flawed cost study.

CONCLUSION

AT&T and WorldCom respectfully request that the Commission adopt the findings and conclusions set forth herein and adopt the recurring and nonrecurring rates proposed by AT&T and WorldCom.

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